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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

**Before The**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
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| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 | ) | MM Docket No. 92-266 |
| | ) | |
| Rate Regulation | ) | |

LIBERTY MEDIA CORPORATION'S
PETITION FOR RECONSIDERATION

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June 21, 1993

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For Basic And Other Cable Programming

## SUMMARY

Liberty Media respectfully submits that the Commission's "tier neutral" benchmark rate regulations are inconsistent with the requirements of the 1992 Cable Act. Rather than considering each of the enumerated factors required by the Act in formulating regulations governing rates for basic and other cable programming service tiers, the Commission has focused exclusively on the rates charged by certain systems facing "effective competition" and has presumed without an adequate factual basis that such rates are "in equilibrium" and sufficient to yield a reasonable profit.

The Commission's benchmarks also disregard marketplace factors which account for a significant portion of the identified rate variances. Specifically, the Commission bases the benchmark rates on three variables -- number of subscribers, channels and satellite-delivered channels -- which account for only approximately 60 percent of the variation in per-channel rates among the surveyed systems. By failing to consider adequately the other relevant statutory and marketplace factors, the Commission establishes arbitrarily low benchmark rates which may force many cable operators to resort to burdensome cost-of-service showings which Congress and the Commission expressly sought to avoid.

Programmers and viewers also are likely to be adversely affected by the Commission's benchmark rate regulations. Arbitrarily low benchmark rates create significant incentives to cease carriage of higher-cost programming or to

shift carriage of such programming from basic or other regulated service tiers to a-la-carte offerings. By applying the same benchmark rates to all regulated service tiers, the Commission disregards significant marketplace differences between carriage on the basic tier and on other service tiers to which all viewers do not subscribe. Finally, by prohibiting cable operators from passing through to subscribers cost increases in "affiliated" programming that exceed the inflation rate, the Commission significantly inhibits the improvement of the very same "innovative" and "original" programming services which have created a "wealth of viewing options for consumers," but which "would not have been feasible without the financial support of cable system operators." Such draconian treatment of affiliated programmers is arbitrary and capricious and inconsistent with Congress' intent to avoid unnecessary constraints on the programming market. Further, the Commission can address any perceived problem with focused remedial provisions which avoid arbitrary penalties to affiliated cable operators and programmers.

Without significant revision, the Commission's rate regulations are likely to inhibit the improvement and expansion of existing programming services and the development and distribution of new services.

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LIBERTY MEDIA CORPORATION'S
PETITION FOR RECONSIDERATION

Liberty Media Corporation ("Liberty Media"), pursuant to Section 1.429 of the Commission's Rules, petitions for reconsideration of the Commission's First Report and Order, FCC 93-177, released May 3, 1993 ("Report & Order") adopting rules to implement the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"). The benchmark rate regulations established by the Report & Order are inconsistent with the requirements of the 1992 Cable Act and will adversely affect the further improvement and expanded distribution of cable programming services.

## Preliminary Statement

The Commission's Report & Order states that the primary concern of Congress in adopting the 1992 Cable Act "is with the exercise of market power by cable system operators, and is not with...those entities supplying cable programming, a market in which there is abundant and increasing competition." Report & Order at ¶8. As the Commission has recognized, the legislative history of the 1992 Cable Act confirms that Congress had "no desire to regulate programming." Id. Consequently, Congress "suggested that the Commission... avoid unnecessary constraints on the cable programming market" in developing regulations to implement the rate provisions of the 1992 Cable Act. Id.

Congress and the Commission repeatedly have cited investment by cable operators in programming services as a critical factor in the development and growth of the "cable programming market," recognizing that such investment has resulted in substantial benefits to programmers and consumers alike. See Amendment of Part 76, Subpart J, Section 76.501 of the Commission's Rules and Regulations to Eliminate the would not have been feasible without the financial support of cable system operators").

Contrary to the Congressional directive that the Commission "avoid unnecessary constraints on the cable programming market" (Report & Order at ¶8), the Commission's rate regulations yield that very result, especially for vertically integrated programmers. Although the Commission contends that its rate regulations will not impair programmers' ability to provide high quality programming and other services to consumers (Id. at ¶9), Liberty Media respectfully submits that the effect of the rate regulations cannot be examined in isolation. Rather, the Commission must consider the cumulative effect on programmers of each successive proceeding to implement the 1992 Cable Act, including the adoption or proposal of regulations which:

- Permit cable programmers to be bumped summarily from established channel positions or dropped in favor of mandatory cable carriage of broadcast stations;

- Increase programming costs for cable operators by encouraging retransmission consent payments to broadcasters while simultaneously reducing revenues through rate regulation, thereby diminishing funds available for cable programming services;

- Subject vertically integrated programmers to burdensome complaint proceedings in which the complainant need not show that the conduct at issue caused any injury;

- Potentially prohibit cable operators with minority interests in programmers from carrying their programming services because of channel occupancy limits;

- Deny vertically integrated programmers the ability to improve existing programming services and to develop new services by prohibiting the pass-through of programming cost increases exceeding inflation to subscribers of affiliated cable operators;

- Discourage investment in high-quality programming services by applying the same arbitrarily low benchmark rate to all programming services regardless of program quality or cost; and

- Create disincentives for cable operators to add new high-quality programming services through the benchmark rate system.

Thus, rather than avoiding "unnecessary constraints" on cable programmers, the Commission's regulations leave vertically-integrated programmers with reduced revenues and opportunities for carriage, potentially burdensome litigation, the inability to recover programming cost increases, and substantial disincentives to continued cable operator carriage of and investment in their programming services. Without significant revision, the Commission's rate regulations are likely to decrease the quality and quantity of the "wealth of viewing options" enjoyed by viewers.

## I. The Commission's Uniform Benchmark Rates For Basic And Other Cable Programming Service Tiers Are Inconsistent With The Specified Statutory Criteria.

Congress and the Commission expressly disavowed any intent to impose cost-of-service regulation on cable operators. Congress instructed the Commission, in regulating basic cable rates, to "seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission." 47 U.S.C. §543(b)(2)(A). Consistent with this instruction, the Commission rejected cost-of-service regulation which "imposes heavy burdens upon regulators and regulatees because of the significant administrative and compliance costs associated with this regulatory model." Report & Order at ¶186. However, by not considering the required sta-

The 1992 Cable Act expressly establishes separate regulatory schemes for basic cable and other cable programming tiers. The Act requires the Commission to adopt regulations to "ensure that the rates for the basic tier are reasonable." 47 U.S.C. §543(b)(1). In prescribing rate regulations for the basic tier, the Commission is required to "take into account" seven enumerated factors[1] and to "seek to reduce the adminis-

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[1] The seven factors which the Commission "shall take into account" in formulating basic rate regulations are:

(i) the rates for cable systems, if any, that are subject to effective competition;

(ii) [illegible]

trative burdens" on subscribers, cable operators, the Commis-

Thus, the statute clearly contemplates that different governmental authorities will enforce different rate standards based on different factors for basic and other cable programming services. See Report & Order at ¶169 (the Act creates a "bifurcated jurisdictional scheme" for regulation of basic and other cable programming rates). Further, the statutory language leaves no doubt that the Commission must use these different criteria for basic and other tiers, i.e. the Commission "shall consider" the enumerated factors. The Commission seeks to justify its "tier-neutral" benchmarks by contending that they are "administratively simpler for cable operators and regulators to use than would be separate requirements for each tier." Id. at ¶130 n.501. However, simplicity of administration cannot sustain regulations which are inconsistent with the statute, particularly where the Com-

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> (D) the rates, as a whole, for all the cable programming, cable equipment, and cable services provided by the system, other than programming provided on a per channel or per program basis;
>
> (E) capital and operating costs of the cable system, including the quality and costs of the customer service provided by the cable system; and
>
> (F) the revenues (if any) received by a cable operator from advertising from programming that is carried as part of the service for which a rate is being established, and changes in such revenues, or from other consideration obtained in connection with the cable programming services concerned.

47 U.S.C. §543(c)(2). Only criteria (B) and (F) are included among the factors for basic tier rate regulation.

mission has failed to determine the marketplace effects of its regulations.

### B. The Commission Failed To Consider The Factors Required By The Statute And Other Relevant Factors In Calculating Benchmark Rates.

Rather than weighing each of the enumerated factors required by the statute in formulating regulations governing for cable service generally at this time." Id. at ¶264. Instead, the Commission proposes to issue a Second Further Notice "to obtain a better record" to ensure that its regulations governing cost of service showings "will correctly balance the interests of consumers in paying a fair rate and of cable operators in earning a reasonable profit." Id. at ¶10. Thus, the Commission clearly did not consider the statutory factor of "a reasonable profit" in establishing its basic benchmark regulations.[3]

The sole "factual basis" for the Commission's Report & Order is provided by "an analysis of the survey of cable rates that we conducted in December 1992." Id. at ¶11. That "analysis" compares rates charged by sampled systems facing "effective competition" with rates charged by other sampled systems, and concludes that "it is quite reasonable to assume that the differential between community units facing effective competition and the random sample of community units not facing effective competition is a 10 percent difference in the

[3] Likewise, despite the statutory mandate to consider "capital and operating costs of the cable system" in establishing criteria to identify unreasonable rates for non-basic cable programming service tiers, the Commission concedes that it does not have sufficient information to formulate cost-of-service regulations governing debt service, depreciation and amortization of equipment and other capital and operating costs. Id. at ¶271. Thus, the Commission could not possibly have factored such considerations into its benchmark rate formula as required by the statute.

price per channel." Id., Appendix E at 13.[4] More importantly, however, the Commission concedes that it simply presumed that the rates reported by systems facing effective competition were "in equilibrium" and were not the result of "price wars" in which rates were set "below cost and may not be sustainable in the long run."[5] Id.

Liberty Media respectfully submits that, before engaging in a regulatory overhaul of cable rates throughout the country, the Commission must ensure that its benchmarks are not derived from limited and unrepresentative information based on extraordinary circumstances in which the rates reported by systems facing "effective competition" could not be sustained profitably in the long run. The statutory man-

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[4] More precisely, according to the Commission, the "best estimate" of the rate differential is "negative 9.4 percent" and, in order to achieve a "95 percent confidence interval" as to the actual differential, the range would have to be expanded to "between -3.6 percent and -15.2 percent." Id.

[5] In previously analyzing the presence and condition of "second cable systems," the Commission noted the "relative paucity of successful competitive cable systems." Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, 5 FCC Rcd. 4962, 5013 n.142 (1990). The Commission then observed that "six competitive systems have failed completely" and "30 such systems have been bought by or merged with the incumbent service provider" while only "40 to 49 directly competitive systems [were] currently in operation." The Commission attributed the small number of such systems to various factors, including "less attractive economics," and "what has been called predatory activity...." Id. Thus, the Commission's presumption of "equilibrium" prices in this proceeding is inconsistent with its prior findings.

date to consider "a reasonable profit" for the cable operator requires no less.

Finally, the Commission benchmark rates are a function of only three variables:

> In essence, the benchmark formula is applied by inserting three characteristics of a given cable system -- the number of channels, subscribers and satellite-delivered signals -- into a mathematical equation.... The rate resulting from the benchmark formula, which will be expressed as a per channel rate, represents the rate that a competitive cable system with the same characteristics as the system subject to regulation would charge.

Report & Order at ¶214. The Commission concedes that other factors excluded from its benchmark formula contribute significantly to variances in the per-channel rates reported by the surveyed cable systems. In fact, while the three variables considered by the Commission "[t]aken together...account for more than 60 percent of the variance in per-channel rates" across all systems sampled by the Commission, other variables which obviously account for nearly 40 percent of the variances in per-channel rates are not factored into the Commission's benchmarks. Id. at ¶210 n.536 and Appendix E at 11 n.18.

The Commission's "survey data do not provide a sufficient basis for identifying additional system characteristics" that account for the other 40 percent of per-channel rate variances. Nevertheless, those characteristics clearly "should be incorporated in our benchmark formula," and the Commission proposes to take further steps to identify those variables and to "reevaluate" its benchmarks in the future. Id. at ¶210. In the meantime, it would be arbitrary and capricious to subject cable operators to benchmark rate regulations which do not account for relevant marketplace factors with an admittedly significant effect on per-channel rates.

### C. The Commission Has Established Unreasonably Low Benchmarks, Potentially Forcing Many Cable Operators To Seek Cost-Of-Service Regulation.

Although the Commission rejects traditional cost-of-service regulation as too burdensome to serve as the primary means of regulating cable rates (Report & Order at ¶186), it proposes to rely on cost-of-service regulation as a fall-back or "secondary method of regulation" where cable operators seek to justify rates above the benchmark. Id. at ¶271 n.637. However, as set forth above, by failing to consider the required statutory criteria and other relevant marketplace factors, the Commission has established arbitrarily low and unreliable benchmark rates. Faced with such benchmarks, many cable operators may be forced to seek cost-of-service regulation, resulting in precisely the type of burdensome regulation which Congress and the Commission sought to avoid.

Having stayed the effective date of its rate regulations until October 1, 1993, the Commission should use the intervening time to identify additional factors which contribute to rate variances and to revise its benchmark rates accordingly. While benchmark rates set at appropriate levels may provide the "simplified form of regulation" envisioned by Congress and the Commission (Id. at ¶8), the current benchmarks may force numerous cable operators to seek burdensome cost-of-service regulation.

## II. The Commission's Rate Regulations Will Adversely Affect Cable Programmers, Particularly Vertically Integrated Programmers.

The adverse effects of the Commission's benchmark rate regulations are not limited to cable operators. Programmers, particularly new programming services and programming services in which cable operators hold attributable interests, will be harmed by the arbitrary benchmarks and cost pass-through regulations adopted by the Commission. Contrary to the intent of Congress, the Commission's rate regulations will create a significant barrier to the development of new and high quality programming services.

rates, even with rate increases for inflation, "might inadvertently harm the continued ability of programmers to develop and produce programming" because the record confirms "that programming costs have increased at a rate far exceeding the rate of inflation." Id. at ¶251. Consequently, in order to "assur[e] the continued growth of programming," the Report & Order provides that cable operators may "pass through to subscribers increases in programming costs" which exceed the rate of inflation. Id.

However, the Commission makes "one important exception to the pass-through of programming costs," capping the pass-through by a cable operator of cost increases for affiliated programming services "at the lesser of the annual incremental percentage increase in such costs or the GNP-PI." Id. at ¶252. To determine whether a particular programmer is affiliated with the cable operator for purposes of the pass-through, the Commission applies the broad attribution standards adopted in the program access proceeding. Id. at ¶252 n.601. Consequently, any cable operator with a five percent or greater interest in a programming service -- whether voting or non-voting -- cannot pass through to its subscribers the inevitable cost increases above inflation attributable to an affiliated programming service.[6]

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[6] As set forth in Liberty Media's Petition for Reconsideration filed June 10, 1993, the attribution standard

Limiting programming cost pass-throughs to the rate of inflation when the Commission has recognized that such cost increases "far exceed" the rate of inflation is arbitrary and capricious. The cost pass-through prohibition will adversely affect viewers as well as those vertically integrated programmers whose "innovative" and "original programming" has contributed substantially to the "wealth of new viewing options for consumers." Network-Cable Cross-Ownership, 7 FCC Rcd. 6156 (1992), at ¶13. Cable operators already facing reduced revenues resulting from rate regulation are unlikely to absorb programming cost increases which they are prohibited from passing on to subscribers. Even if a programmer were inclined to offer a reduced rate to secure carriage by the affiliated cable operator, the programmer would likely face discrimination complaints from other distributors under the program access rules. Where cable operators choose to drop affiliated programming or to shift that programming to unregulated a-la-carte offerings rather than absorb cost increases, consumers would be deprived of popular programming or forced to pay more for it. Programmers would be forced to increase rates

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presume that a cable operator with a five percent non-voting or limited partnership interest in a programmer could control the programmer's operational decisions when 100 percent of its voting stock is held by third parties simply ignores fundamental principles of state law. The Commission compounds this oversight by simply incorporating the program access attribution standard in this proceeding, which involves issues completely different from those underlying the Commission's attribution decision in the program access proceeding.

to unaffiliated distributors to compensate for lost revenues. In short, no one would benefit from the prohibition on pass-throughs of affiliated program cost increases except those non-affiliated services which compete with affiliated programmers.

Moreover, there is no need for such draconian treatment of affiliated programmers. First, Congress and the Commission have recognized that the cable programming marketplace is characterized by "abundant and increasing competition." Report & Order at ¶8. Consequently, cable operators and affiliated programmers do not have the market power to implement unreasonable price increases in the programming marketplace. Further, as recognized by the Commission, "cable operators also have incentives to assure that service rates are not excessive since excessive programming costs, if passed on to subscribers, may cause them to lose subscribers." Id. at ¶251. Faced with unreasonable increases, affiliated and unaffiliated cable operators will substitute other programming services.

To the extent the Commission is concerned "about abuses that might occur if we permit vertically integrated cable operators to engage in unlimited pass-throughs of programming costs to their subscribers" (Id. at ¶252), the Commission could provide for limited additional scrutiny where cost increases for affiliated programming exceed the cost increases for the same programming service to non-affiliated cable operators.[7] Liberty Media submits that this approach to affiliated program cost increases is far more consistent with the intent of the 1992 Cable Act to "avoid unnecessary constraints on the cable programming market" (Id. at ¶8) than the absolute and plainly arbitrary prohibition on pass-throughs of affiliated program cost increases adopted by the Commission.

B. The Commission's Benchmarks Discourage Carriage Of High-Quality Programming Services On Regulated Service Tiers And Development Of New Services.

As set forth supra at 13-14, the benchmark rates established by the Commission are based exclusively on three variables: the number of subscribers, channels, and satellite-delivered signals. Under the Commission's formula, these factors combine to yield a single benchmark rate which applies to each channel carried on the basic or other cable program service tiers, regardless of the quality or cost of the programming carried on a particular channel. As a result, providers of more expensive and higher-quality programming services, including regional sports services, will face increasing pressure from cable operators to shift from basic or expanded basic carriage to a-la-carte offerings or such services may be dropped. A shift to a-la-carte for such services

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[7] Where the affiliated programming is not carried on the basic tier, the Commission could conduct the same limited inquiry in response to any complaint brought by a subscriber.

would substantially decrease their audiences and advertising revenues.

Further, a uniform benchmark rate for basic and other cable programming services does not account for the realities of the cable programming marketplace. The Commission has recognized that programmers historically have negotiated different prices, terms and conditions of carriage depending upon the cable operator's commitment to carry its programming service on the basic, expanded basic, or other service tiers. See First Report and Order in Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992, FCC 93-178 (rel. April 30, 1993), at ¶111; Comments of Liberty Media in MM Docket No. 92-265, submitted January 25, 1993, at 36 ("[B]ecause the method of carriage (e.g. basic tier, tier or a-la-carte) may significantly affect the number of subscribers for which a given rate is paid, programmers may adjust their rates to encourage different methods of carriage"). The Commission's "tier-neutral" benchmark approach disregards such market differences. By using the same benchmark rates for non-basic tiers, the Commission's rate regulations substantially limit programmers' flexibility to price their services to account for differences in subscriber reach resulting from carriage of its programming on basic or other cable program service tiers.

In addition to penalizing existing higher-quality and more expensive programming services, the Commission's benchmark rates will discourage the development of new and innovative services providing high-quality programming. Specifically, the Commission's benchmark formula appears to be structured so that the benchmark rate applicable to all channels decreases as the cable operator adds channels. Consequently, the marginal revenue from the addition of each channel decreases if carriage of the new channel does not significantly increase overall subscribership. Thus, the amount which the cable operator can profitably afford to pay for each new service would decrease under this interpretation of the benchmarks.

For example, a cable operator with a 20-channel system, 10 satellite channels, and 1,000 subscribers has a per-channel benchmark rate of $0.933. Adding another satellite channel would decrease the benchmark rate to $0.902 per channel. If it is assumed that the operator neither adds subscribers nor incurs transaction or other costs as a result of the additional channel, its monthly revenue will increase by $282. Consequently, if the cost of the new programming service is greater than $0.282 per subscriber per month, the operator will lose revenue by adding the channel. Under this interpretation of the benchmark rates, as the number of channels increases, the "break-even" cost of any new programming substantially decreases. For example, a system with 90 channels, 45 satellite channels and 1,000 subscribers desiring to add five satellite-delivered channels would have to purchase the programming at an average cost of $0.095 per channel to break even (not including transaction costs), assuming that no increase in subscribership results from the five additional channels. Thus, as more channels are added, a steadily declining benchmark rate would discourage the development and carriage of higher-quality and higher-cost programming.

Liberty Media respectfully suggests that, to avoid this result, the Commission should clarify its benchmark rules such that channels added by a cable operator after the implementation of rate regulation should not affect its applicable benchmark rate. Instead, cable operators should be permitted to add new channels and to adjust the price of the tier to which the channels are added by an amount reflecting the cost of the new programming plus a reasonable rate of return. This approach would avoid the disincentive to additional channels resulting from a steadily declining benchmark rate applicable to all channels as each new channel is added. Such approach clearly fosters the Commission's stated intention of "assuring